A Work Project, presented as part of the requirements for the Award of a Master Degree in Finance from the NOVA – School of Business and Economics.

AIRBUS A321XLR LAUNCH

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A Project carried out on the Master in Finance Program, under the supervision of:

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January 3rd, 2020

Abstract

This report aims to analyze the launch of the new single-aisle A321XLR by Airbus SE, which was presented during The Paris Air Show on June 2019. According to specialists, the brand-new aircraft is expected to be the generational turning point in the history of aviation. In this report the aviation sector, the Long-haul market, the company share price and the investment opportunities and risks are presented. Airbus may be able to collect market share on the Long-haul market as A321XLR's greatest competitor is currently grounded (Boeing 737 Max).

Keywords

Airbus A321XLR, Long-Haul Market, Efficiency

This work used infrastructure and resources funded by Fundação para a Ciência e a Tecnologia (UID/ECO/00124/2013, UID/ECO/00124/2019 and Social Sciences DataLab, Project 22209), POR Lisboa (LISBOA-01-0145-FEDER-007722 and Social Sciences DataLab, Project 22209) and POR Norte (Social Sciences DataLab, Project 22209).

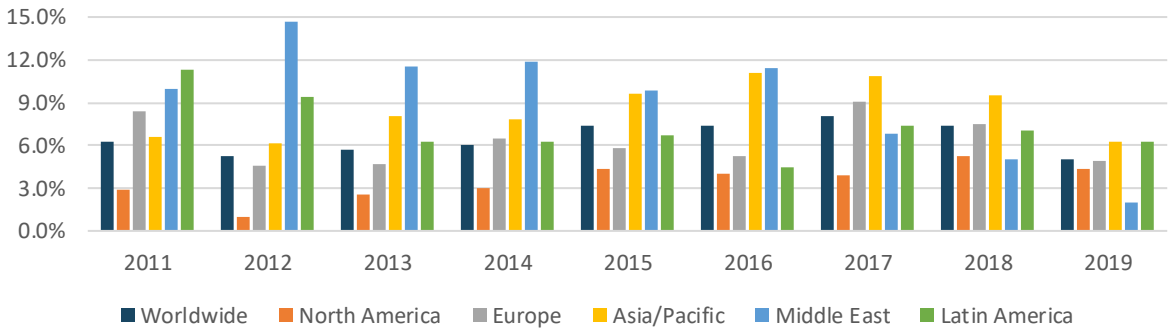
Following its vision of airplanes with reduced fuel consumption, Airbus SE presented the new single-aisle A321XLR during The Paris Air Show on June 2019. The first unit of the new A321XLR will see the light of the day in 2023 and intends to penetrate the long-haul market by bringing 30% lower fuel burn per seat than its previous generation competitor while allowing for longer distances. The key milestone would represent a disruptive entrance in the worldwide aircraft long-haul market following the recent news on the Boeing 737MAX, enforcing Airbus momentum as one of the largest aircraft manufacturers in the world, while being committed to the International Air Transport Association' ("IATA") guidelines for carbon offsetting.

Aviation Sector

As in any airline related market, the aircraft market is mainly driven by two economic drivers – GDP growth and revenue passenger kilometers ("RPKs").

RPKs, as an air traffic revenue measure, is the main driver for airlines companies, as these companies predict their business' needs for the future in accordance to this ratio performance. Thus, RPKs indirectly affects aircraft manufacturers. RPKs has been increasing since 2011 in all regions of the globe, with historical numbers pointing towards a 6.5% growth average worldwide. Despite a slight decrease in growth, RPKs is becoming steadier in the past 3 years and it is expected that the growth of this ratio will remain within a range between 4.5% and 5.5% in the foreseeable future, supporting strong aircraft demand (Exhibit 1).

Exhibit 1 *– Revenues Passenger Kilometer growth per region (2011 – 2019)*



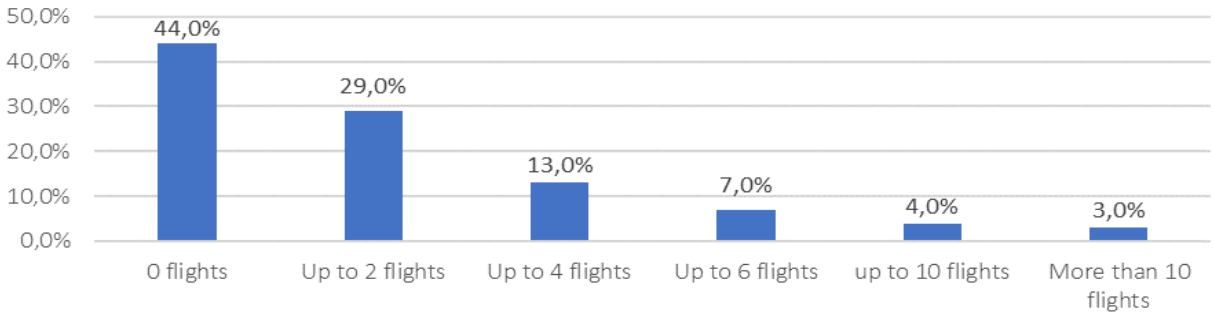
Source: Statista, June 2019

Regarding GDP growth, as stated in the company report, this plays an important role for the demand for of aircrafts, being the most significant indicator of a country's economic health and wealth. As GDP increases, countries see their tourism increasing alongside with their business centers, and thus Airlines' companies get more stable and are able to keep profitable routes running.

Long-Haul Market

The Long-haul market is generally defined as any direct or non-stop flight that has a journey time of between 6 - 12 hours. It is the largest in terms of demand with c. 56% of the inquired passengers travelling at least 1 long-haul flight last year (Exhibit 2). With the number of passengers travelling further distances each year only increasing, it wouldn't be expected to have huge planes, such as the A380 with its double-deck cabin, not fully filled. However, Airbus noticed the arising problem and will not produce this aircraft anymore from 2021. Instead, Airbus is putting its bets on the new single aisle aircraft, the A321XLR.

Exhibit 2 - Long-haul flights per passenger during 2018



Source: Statista, June 2019

The long-haul aviation is a history of conquering distance while increasing the aircrafts flexibility. For many years, it was required large and multi-engine aircrafts to be able to meet the requirements to fly those routes. Furthermore, there are a few percentages of airports that are capable of receiving such aircrafts, and thus, it leads to passengers having to change to smaller aircrafts to reach their destination. As published in a Forbes' article, interviewed specialists say that we will look back and see the single-aisle A321XLR as the generational turning point in the history of aviation – it was a predictable step, but yet nonetheless remarkable for its impact on the development of global air networks, as well as for the opportunity that it creates for smaller airports and smaller cities.

Aviation shifting towards an Environmental concerned sector

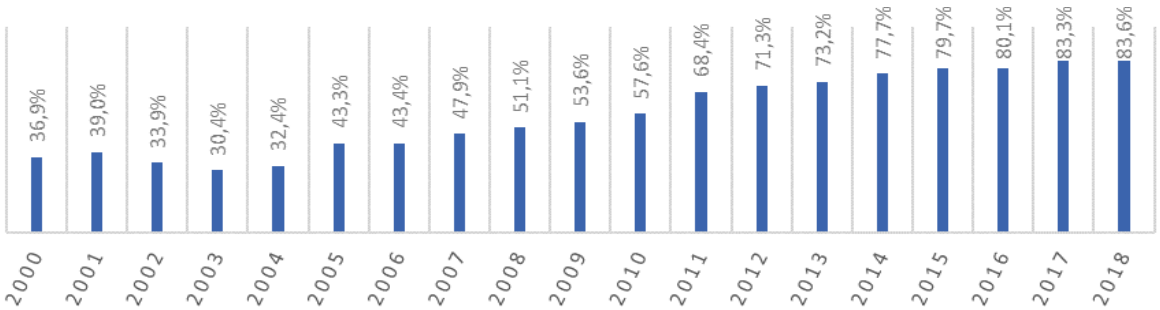
Representing 230 airlines across 118 countries, IATA coordinates how the sector evolves in respect to climate change concerns. In 2008, IATA formally adopted a set of ambitious targets to mitigate CO2 emissions from air transport (which accounts for c. 2% of global carbon emission) after historically being a sector that left the measures in charge of each individual company regulations (including carbon offsetting). Based on its technological and efficiency' pillars, IATA aims to improve fuel efficiency 1.5% per year on average and a reduction in net

aviation CO2 emissions by 50% by 2050, relative to 2005 levels. In 2016, the International Civil Aviation Organization ("ICAO") established a global offsetting mechanism, called Carbon Offsetting and Reduction Scheme for International Aviation ("CORSIA") which aims to help address any annual increase in total CO2 emissions from international civil aviation above 2020 levels. Airbus adopted CORSIA, having to report and monitor the CO2 emissions, showing the company's commitment to environmental causes.

Airbus situation as a tendency for the market

Looking back on January 2015, Airbus' shares were trading at $59.42 per share. Healthy dividends were promised to Airbus' investors as a result of its investments in the 'neo' family. During an investor event in London, Airbus' Chief Financial Officer, Harald Wilhelm, reassured investors that there was a risk that the dividend rate could decrease, however the point was that the 'neo' family would ramp up and provide a clear bridge into profitability. After five years, Airbus' shares more than doubled its price. On the last quarter of 2018 Airbus stock has fallen nearly 28.9% due primarily to fears over quantitative tightening and continuing trade tensions between United States and China. These tensions had a quick impact in most of the worldwide companies, during a quarter that global equity markets suffered a sharp decline. However, Airbus stock has risen c. 62.5% since December 2018 due to investors sentiments regarding the projects that the company was undertaking and following to Boeing's retracement provoked by the grounding restrictions on the 737 Max since mid-March. Airbus saw 5,990 units of its A320 family being order during 2018, which accounts for 83.6% for its total orders showing a risen tendency for a bigger focus on manufacturing smaller airplanes, less heavy and with larger flexibility. Since the 'family model' inception, the A320 family already had 52,940 orders (c. 65.5% of total orders) and had as turning points the year of 2005 and 2011 where the search for the famous aircraft line grew 34.0% and 18.8% versus the year before, respectively.

Exhibit 3 *– Airbus' A320 family orders as percentage of total orders*



Source: Bloomberg

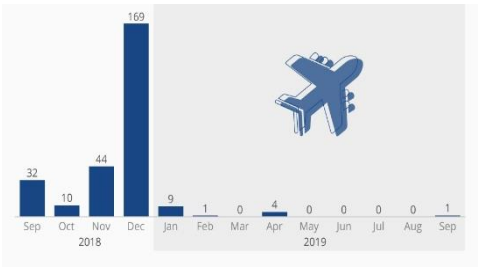
The Airbus A321 had a total of 13,031 units ordered since 2000 and accounts for 16.1% of total orders over the same period.

Investment opportunity

As stated before, Airbus SE launched in June 2019 the Airbus A321XLR. This airplane represents both the efficiency and the long distance that the company is aiming to achieve and has as the main opponent the Boeing 737Max which is now awaiting the authorization to fly by the Federal Aviation Administration ("FAA") that maintains its review on the aircraft safety as well as the proposed changes.

The aircraft will be ready to fly during the year of 2023 and already has c. 240 units ordered. Since almost no orders were placed on the troubled Boeing's aircraft from 2019 and going forwards, Airbus may expect to take advantage from the 4,600 Boeing 737Max that are currently grounded in each respective holder's hangar as airlines may have to start looking for new solutions, by offering a more efficient aircraft that is approved by the regulatory agency.

Exhibit 4 *– Monthly orders of the Boeing 737 Max*



Source: Statista, June 2019 (sourced from Boeing)

Airbus is also ready to obtain increased revenue potential by offering airlines brand-new options for configuring the cabin, allowing more flexibility as well as more efficient use of cabin space without compromising passenger comfort.

Up to the date, low-cost, long-haul travel was pipe a dream. However, the "game" has recently changed with the fuel-efficient aircrafts (that Airbus introduced in the market as the pioneer and was followed closely by its peers) as well as with the European and Asian airlines pushing aggressively on price competition. The opportunity has come for the low-cost airlines and alongside it, the opportunity for the aircraft manufacturers to fulfil the market with its technologies.

On an environmental concerned society, Airbus is avoiding fines and being strongly committed to CORSIA with the launch of the new aircraft, while putting South America and Europe within reach of several North America hubs and making possible to create new routes between Europe and Asia, and from Asia to Oceania.

Further to all the above, and being steady all the market conditions previously stated, there is a clear opportunity for Airbus to get market share towards its major peer on the long-haul market, as RPKs keep growing year after year, and to be able to take profits from all the Research and

Development ("R&D") investments that the company has undertaken in the past few years.

Investment risks

Although theoretically expected that Airbus should benefit from its American peer' issues, Boeing's losses might not be Airbus' gains – even if Boeing's pain should still be Airbus' gain. This is due to the fact that airlines that switch suppliers are entitled to financial penalties, and thus, it might not be gainful to actually do it if Boeing will be able to give some guarantees on when their 737 Max will be ready to fly again – subject to the fact that 4,600 units will need intervention and 200 more were locked on a contract with IAG (British Airways' parent company).

Further to the above, Airbus will have to keep its rate of production in order to be able to receive and meet 'unexpected' orders, as the queue could be for years if all Boeing' losses would belong to Airbus. Given this, it is expected that other manufacturers will collect gains from Boeing's disaster.

The result from the trade war between United States of America and China will play an important role as United States is threatening tariffs of 10 percent on the European-manufactured Airbus planes as punishment for the allegedly illegal EU aircraft subsidies.

Not only the economic instability that the world is facing due to the above, the recent retracement of the yield curve which is currently inversed is showing signs that economic growth may be slowing around the globe and is taking confidence out of the investors.

On an internal analysis, it is expected that on the following two years' major section chiefs of the company will retire. In fact, the former head of sales, John Leahy, considered an extraordinaire salesman who is estimated to bring €1.6 trillion in aircraft sales during his career, retired last year. Instability is creating fear amongst the investors, and it might be worth to keep an eye on any departure before investing.

To conclude, Airbus A321XLR launch prospects might be too optimistic given the innovative turning point that might create within the industry, however Airbus will need to maintain its disruptive entrance in the long-haul market in order to be able to collect its share of the market gap that is arose from Boeing's failures. As one of the biggest players in the industry, – and also as the pioneer on the fuel and distance efficiency – Airbus needs to be able to capture a share of Boeing's long-haul clients while staying committed to produce its current orders and its new orders on the A321XLR in order to have the value coming from this market opportunity reflected in its share price.

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